

# Parmenion

## Strategic Ethical Active Profile D: Traditional Ethical Leaders

Quarterly Update, Q4 2023



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## The big picture: Macro and Markets

### In a nutshell

- **Markets rallied as investors got excited about the prospect of interest rate cuts in 2024**

Both equities and bonds delivered meaningfully positive figures, putting a tough Q3 firmly in the rearview mirror, and perhaps flattering overall returns for the year.

- **Geopolitical unrest and conflict continues**

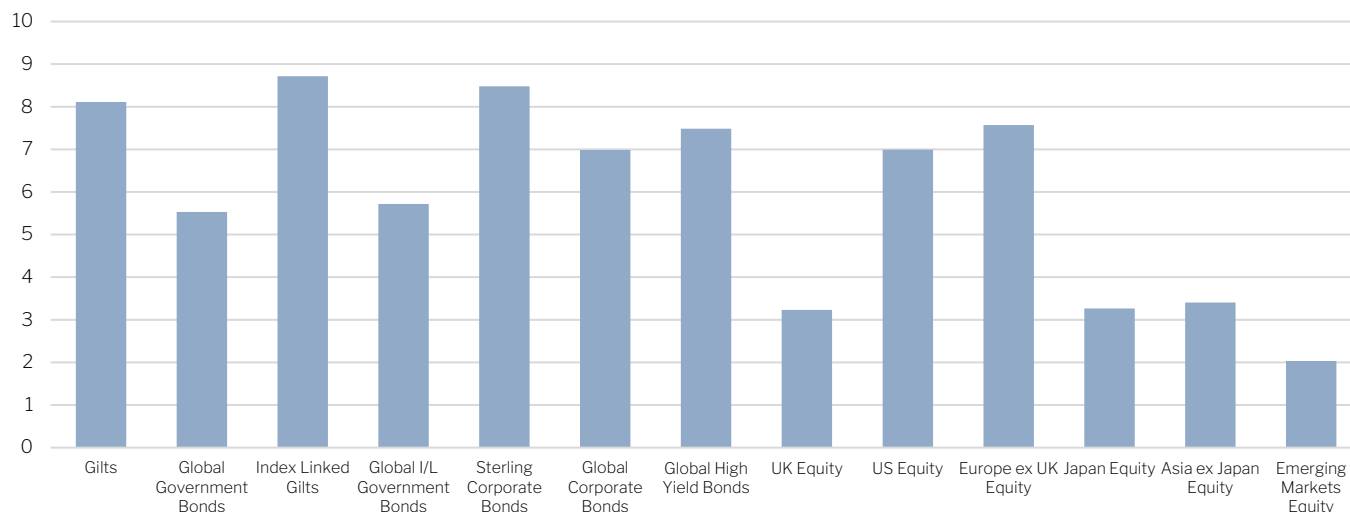
The Ukraine/Russia and Middle East conflicts continued without any signs of a resolution, yet markets remain undeterred.

- **10y government bond yields in the UK fell from 4.5% to 3.5%**

A 1% drop in UK Gilt yields over the 3-month period resulted in meaningful capital appreciation, and when combined with the income generated, a very healthy overall return, particularly for lower risk investors.

# What's been happening in Q4?

## Asset class returns (Q4 2023)



A strong final quarter of the year gave some more festive cheer to investors. Both equities and bonds delivered meaningfully positive figures, putting a tough Q3 firmly in the rearview mirror, and perhaps flattering overall returns for the year.

Most of 2023 has been characterised by a seemingly uncertain economic backdrop, yet riskier assets (equities) outperformed more defensive areas (bonds and cash). This was reversed somewhat in Q4, with Gilts leading the way (8.11%) – a welcome change for lower risk clients who've had a challenging time lately.

The idea of multiple rate cuts in 2024 really took hold of the market - driven by inflation continuing to fall (often faster than expected) – and in turn this pushed yields down. The 10 Year Gilt yield dropped from around 4.5% to 3.5% over the 3-month period resulting in meaningful capital appreciation, and when combined with the income it generated, a very healthy overall return.

The odds of the Fed manoeuvring a 'soft landing' seem to be increasing - at least in the eyes of the market. Combined with the expectation of rate cuts next year, this is propelling equities upwards. Much has been said about the Magnificent Seven leading the charge, but in the final quarter the rally broadened out, with many smaller companies performing well. This suggests investors are growing more confident in the economy, rather than just backing a handful of global technology leaders.

Negative sentiment around China continued to weigh on Asia Pacific and Emerging Market returns. Anticipation around policy support for the Chinese property sector and broader economy remains, but measures so far haven't given investors enough confidence to move money into the region.

The last quarter of the year reminded us that the attractiveness of cash is always relative. Missing out on the good months in markets can materially impact long term plans, regardless of interest rates on offer.

# What does that mean for performance?

## Cumulative Performance

	Q4	YTD	1 Year	3 Year	5 Year
Risk Grade 1	3.45	6.49	6.49	-0.33	6.43
<b>IA Standard Money Market</b>	<b>1.38</b>	<b>4.74</b>	<b>4.74</b>	<b>6.03</b>	<b>7.26</b>
Risk Grade 2	5.24	7.72	7.72	-1.19	11.61
Risk Grade 3	6.26	8.57	8.57	-0.87	17.36
Risk Grade 4	7.20	9.30	9.30	-0.50	22.43
<b>IA Mixed Investment 0-35% Shares</b>	<b>5.62</b>	<b>5.97</b>	<b>5.97</b>	<b>-2.86</b>	<b>9.70</b>
Risk Grade 5	7.51	9.39	9.39	0.26	27.02
Risk Grade 6	7.87	9.65	9.65	1.39	32.01
<b>IA Mixed Investment 20-60% Shares</b>	<b>5.65</b>	<b>6.81</b>	<b>6.81</b>	<b>3.66</b>	<b>20.00</b>
Risk Grade 7	8.07	9.71	9.71	2.24	35.71
Risk Grade 8	7.64	9.30	9.30	4.12	40.42
<b>IA Mixed Investment 40-85% Shares</b>	<b>5.76</b>	<b>8.08</b>	<b>8.08</b>	<b>7.87</b>	<b>31.54</b>
Risk Grade 9	7.23	8.96	8.96	6.00	44.81
Risk Grade 10	6.86	8.66	8.66	7.94	48.87
<b>IA Flexible Investment</b>	<b>5.27</b>	<b>7.08</b>	<b>7.08</b>	<b>8.47</b>	<b>33.86</b>

## Discrete Annual Performance


	2023	2022	2021	2020	2019
Risk Grade 1	6.49	-5.84	-0.60	2.98	3.69
<b>IA Standard Money Market</b>	<b>4.74</b>	<b>1.28</b>	<b>-0.05</b>	<b>0.43</b>	<b>0.73</b>
Risk Grade 2	7.72	-9.14	0.95	4.88	7.70
Risk Grade 3	8.57	-11.31	2.95	5.19	12.56
Risk Grade 4	9.30	-13.11	4.78	6.70	15.31
<b>IA Mixed Investment 0-35% Shares</b>	<b>5.97</b>	<b>-10.87</b>	<b>2.84</b>	<b>3.90</b>	<b>8.70</b>
Risk Grade 5	9.39	-14.21	6.83	8.04	17.26
Risk Grade 6	9.65	-15.11	8.92	9.37	19.05
<b>IA Mixed Investment 20-60% Shares</b>	<b>6.81</b>	<b>-9.47</b>	<b>7.20</b>	<b>3.51</b>	<b>11.84</b>
Risk Grade 7	9.71	-15.67	10.50	10.14	20.52
Risk Grade 8	9.30	-15.15	12.27	10.90	21.61
<b>IA Mixed Investment 40-85% Shares</b>	<b>8.08</b>	<b>-10.04</b>	<b>10.94</b>	<b>5.32</b>	<b>15.78</b>
Risk Grade 9	8.96	-14.66	13.99	11.65	22.36
Risk Grade 10	8.66	-14.20	15.77	12.41	22.70
<b>IA Flexible Investment</b>	<b>7.08</b>	<b>-8.98</b>	<b>11.30</b>	<b>6.70</b>	<b>15.66</b>

# What worked and what didn't?


It's pleasing to report a very strong quarter, after what has been a tough environment for ethically orientated investors lasting 2 years. The Strategic Ethical Active portfolios finished comfortably ahead of their respective IA sectors over the fourth quarter of 2023 (aside from Risk Grade 2, which fell ever so slightly behind).

The strength of the outperformance greatly improves the rolling 1 year picture too. The turnaround in performance is a direct result of inflation cooling more than expected. High levels of inflation have been a major stumbling block for our Ethical Solutions given their inherent growth biases. Regardless of risk level, returns have been strong during the quarter.


## Asset classes



Capital markets reacted strongly to inflation rolling over more than expected, as this led to renewed optimism around rate cuts for 2024. In this environment both bonds and equities delivered positive absolute returns over the quarter. Interest rate sensitive areas performed most favourable in the 'everything rally'. Equities delivered strong absolute returns in this environment too, with ethical equities flourishing due to their indirect linkage to the growth style.



Although still delivering well over a short time frame, emerging market equities failed to keep up with the wider rally and recorded the weakest rise across all the regions. Valuation levels remain attractive but the structural problems in China, particularly around its property sector continue to weigh on economic activity and dragged down the index level return.



After such positivity and hype around money market funds over 2023, investors were better placed taking on market risk during the quarter. This illustrates the dangers of market timing. In truth there was little negative to say around the performance of the solution as all asset classes performed well over the period. A welcomed rarity and we expect for correlations to reassert themselves during 2024.

## Manager selection

Given the market environment, most funds strongly outperformed their respective benchmarks. The UK Equity holdings all performed well, with Aegon Ethical Equity (Risk Grade 2-10) delivering significant outperformance. The fund's stock selection in financials and industrials drove the strong returns over the quarter. Liontrust UK Ethical (Risk Grade 2-10) also performed very strongly, as the fund's return was bolstered by its exposure to small and mid-sized companies.

Janus Henderson Global Sustainable Equity (Risk Grade 2-10) outperformed over the quarter, spurred on by its strong growth bias illustrated by its overweight to the technology sector and zero exposure to traditional energy stocks. Liontrust Sustainable Future Global Growth shot up a staggering 13% during the quarter, doubling the return of its benchmark. The fund's stock selection proved helpful, particularly in areas such as industrials and healthcare stocks. Although this is on the back of some poor performance from the fund over recent times.

Within Sterling Corporate Bonds (Risk Grade 1-9), Rathbone Ethical Bond & CT Responsible Sterling Corporate Bond negatively detracted from a relative return sense given their slight underweight duration positions. However, Liontrust Sustainable Future Corporate Bond performed strongly and so the asset class was broadly in line with the index.

There were no outright significant negative detractors to talk through this quarter.

## Fund changes

Sell

**Aberdeen Standard Liquidity  
Federated Hermes Short-Term Sterling Prime**

Buy

**BlackRock ICS Sterling Liquid Environmentally  
Aware**

The funds held in our Managed Liquidity asset class (Risk Grade 1-6) are unscreened, which means they either have no exclusion policies, or they are very light. We've been looking to improve the screened nature of the asset class for our Ethical solutions in favour of a more environmentally aware money market fund. We therefore switched out of the Federated Hermes Short-Term Sterling Prime and Aberdeen Standard Liquidity in all our Ethical solutions, in favour of the BlackRock ICS Sterling Liquid Environmentally Aware fund. The fund has an environmental tilt and strong exclusionary policies. This is therefore a stronger candidate for our Ethical portfolios.

## A view on risk

	Volatility			Max Drawdown		
	1 Year	3 Year	5 Year	1 Year	3 Year	5 Year
Risk Grade 1	2.60	3.46	3.10	-0.56	-8.83	-8.83
<b>IA Standard Money Market</b>	<b>0.28</b>	<b>0.64</b>	<b>0.54</b>	<b>0.00</b>	<b>-0.10</b>	<b>-0.10</b>
Risk Grade 2	4.59	5.41	5.11	-1.12	-12.80	-12.80
Risk Grade 3	5.98	6.97	7.06	-1.70	-15.20	-15.20
Risk Grade 4	7.32	8.40	8.69	-2.88	-17.18	-17.18
<b>IA Mixed Investment 0-35% Shares</b>	<b>5.94</b>	<b>6.03</b>	<b>6.48</b>	<b>-3.31</b>	<b>-13.28</b>	<b>-13.28</b>
Risk Grade 5	8.27	9.32	9.85	-3.97	-18.22	-18.22
Risk Grade 6	9.05	10.18	11.02	-4.75	-19.01	-19.01
<b>IA Mixed Investment 20-60% Shares</b>	<b>6.78</b>	<b>6.87</b>	<b>8.45</b>	<b>-3.68</b>	<b>-12.14</b>	<b>-12.89</b>
Risk Grade 7	9.84	10.87	11.80	-5.57	-19.35	-19.35
Risk Grade 8	10.08	11.08	12.29	-5.95	-18.33	-18.33
<b>IA Mixed Investment 40-85% Shares</b>	<b>7.71</b>	<b>8.24</b>	<b>10.29</b>	<b>-4.39</b>	<b>-12.54</b>	<b>-15.41</b>
Risk Grade 9	10.31	11.33	12.78	-6.39	-17.34	-17.34
Risk Grade 10	10.60	11.66	13.29	-6.95	-17.20	-17.41
<b>IA Flexible Investment</b>	<b>7.49</b>	<b>7.91</b>	<b>10.17</b>	<b>-4.31</b>	<b>-11.20</b>	<b>-15.53</b>

## What's the outlook?

We think the long-term outlook for Ethical and ESG investing remains positive. Inflationary headwinds are expected to moderate throughout 2024, with central bank and investor focus shifting towards growth and away from inflation.

Variable macroeconomic data will keep central bankers talking tough; however, we believe we've passed the peak in interest rates with cuts expected not only in 2024 but into 2025 as well. Slower economic growth points to weaker earnings growth. This suggests there'll be a greater focus on quality within fixed interest and equities, and a need for duration to hedge against unforeseen risk off events.

Within fixed interest, government bonds (rates) look more appealing than corporate bonds (credit), where spreads have narrowed to below their historical averages. On a risk adjusted returns basis fixed interest is looking relatively more attractive than equities at this stage of the cycle. However, valuation opportunities remain, with mid and small caps looking attractive not only versus core indices but also against their own history.

ESG priorities are coming back to the forefront of investors' minds, as the clock for limiting temperature rises continues to count down. The capital expenditure needed to prevent climate catastrophe and create a better world for future generations is huge. Then there's the increased regulations. Both of these create big risks to those companies and industries not willing to embrace change. But it also creates attractive opportunities for those making positive steps on the path to sustainability. Our Ethical Oversight Committee – a panel of ESG specialists and Parmenion Investment Management - meet each quarter to assess opportunities and threats in the current ESG landscape.

In addition to a performance review, we also aim to share some details around the type of positive work conducted by our underlying fund managers within your ESG portfolios. Over Q3 2023, the managers of Janus Henderson's Global Sustainable Equity Fund (not held in Risk Grade 1) undertook 12 different engagements. Including with North American home-improvement retailer Home Depot. They first engaged with the company in 2022, supporting a successful shareholder proposal calling to eliminate deforestation in their supply chain. A recent follow-up confirmed that Home Depot had completed a deep dive into supplier activity and were finalising a full report, alongside beginning to disclose activity through CDP Forests. However, disclosures so far have been limited and Janus Henderson will speak to management again once full reporting is published later in the year.



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## Get in touch

If you'd like to chat to us about our ethical solution range, please get in touch.

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